

22.05 Example #4 – Noncontrolling Interest

When one entity obtains a controlling financial interest in another entity, it may or may not entail the acquisition of the acquiree's equity securities, such as when a primary beneficiary has a controlling financial interest in a VIE. In addition, even when it does, the acquirer often acquires less than 100% of the acquiree's outstanding stock. The portion of the acquiree's equity that is held by parties or entities other than the acquirer is referred to as the **noncontrolling interest**.

The noncontrolling interest is considered a portion of shareholders' equity and is required to be reported in the shareholders' equity section of the balance sheet. It is originally recognized at fair value as of the date of acquisition:

- If the shares are traded in an active market, the per share market value will be multiplied by the number of shares owned by others.
- If the shares are not traded in an active market, an alternative method will be applied in determining fair value.

The noncontrolling interest is adjusted for:

- The noncontrolling interest's share of the acquiree's net income; and
- The noncontrolling interest's portion of distributions by the acquiree.

The consolidated I/S will include the revenues, expenses, gains, and losses of both the acquirer and the acquiree.

- The I/S effects of interentity transactions, including sales of merchandise, the performance of services, loans, leases, and the sale of other assets, are eliminated.
- The result is considered consolidated net income.
 - A portion, equal to the acquiree's unadjusted net income multiplied by the noncontrolling interest's percentage ownership in the acquiree, is allocated to, and recognized as an adjustment to the noncontrolling interest.
 - The remainder is allocated to the acquirer and recognized as an adjustment to retained earnings.

A similar approach is used in allocating other comprehensive income. The consolidated statement of other comprehensive income, or combined statement if the one-statement approach is used, will reflect all items of other comprehensive income for the period for both the acquirer and the acquiree, after eliminating interentity items, if any.

- A proportionate amount of those attributable to the noncontrolling interest's share is allocated to, and recognized as an adjustment to, the noncontrolling interest.
- The remainder is allocated to the acquirer and recognized as an adjustment to accumulated other comprehensive income.

Class Example #4

Assume that P Co. acquired 90% (10% noncontrolling interest) of the stock of S Co. in an acquisition on 12/31/X1 for a payment of \$900 cash. At the date of acquisition, S Co. had 100,000 shares of stock outstanding with an FMV of \$8 per share. The book value of S was \$600, and all of the assets and liabilities had fair values equal to their book values, with the exception of equipment with a remaining life of 5 years and a fair value \$100 higher than book value. The accounts of the two companies at 12/31/X1 are presented in a worksheet, along with the combining entry.

The consolidating worksheet would appear as follows:

Purchase price	\$ 900	
FMV	\$ 700	}
BV	\$ 600	FMV increment

The FMV of the noncontrolling interest at the date of acquisition is $100,000 \times \$8 = \$800,000 \times 10\% = \$80,000$.

The calculation of Goodwill or Gain is as follows:

Fair value of consideration transferred (cost to the acquirer)	\$900,000
+ Fair value of previously held equity interests in acquiree	0
+ Fair value of noncontrolling interest	\$ 80,000
(-) <u>Fair value of net identifiable assets of acquiree</u>	<u>(\$700,000)</u>
Goodwill or Gain from bargain purchase	\$280,000

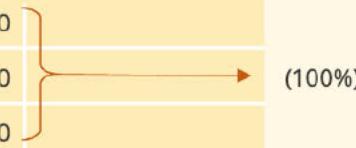
Accounts	P Co	S Co	Debits	Credits	Consol
Cash	100	100			200
Equipment	8,000	500	100		8,600
Inv in S	900			900	--
Goodwill			280		280
\$1 CS	(1,000)	(100)	100		(1,000)
APIC	(3,000)	(100)	100		(3,000)
Noncontrol Int.				80	(80)
RE	(5,000)	(400)	400		(5,000)

Keep in mind that the income reported for 20X1 will be the **Acquirer's income only**, since purchases are accounted for prospectively, not retroactively. The acquiree's income (or 90% of it, in the case of a 90% purchase) is included from the date of purchase onward.

To acquire 90% of Investment: (Noncontrolling interest) (In books)

Investment	900
Cash	900

To consolidate: (On worksheet)

C/S	100		(100%)
APIC	100		
R/E	400		
Equipment	100		
Goodwill	280		
Investment			900
Noncontrolling int. (minority int.)			80 (\$800 FMV x 10%)